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SPECIAL REPORT

IMPACT OF NEW SOVIET INDUSTRIAL AID PROGRAM IN IRAN

CENTRAL INTELLIGENCE AGENCY

OFFICE OF RESEARCH AND REPORTS

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IMPACT OF NEW SOVIET INDUSTRIAL AID PROGRAM IN IRAN

The marked improvement in Iran's relations with the Soviet Union in the past two years has provided the Shah with an opportunity to achieve one of his country's long-standing ambitions--the acquisition of a steel mill as the key item in a major industrial development program. In addition to the integrated steel complex financed with a Soviet loan of $286 million, the program includes a machine tool plant and a major gas pipeline extending from southern Iran to the Soviet border. Substantial secondary economic benefits may eventually be realized. First, however, Iran must find the means to make a large investment outlay on its own, and the need for additional foreign exchange revenues is already bringing pressure on Western oil companies to step up production.

A National Goal

Iran first attempted to obtain a steel mill from Germany in 1936, but by the time negotiations had concluded World War II had started and the project was not carried through. Since the war, feasibility studies by US, German, Swedish, Belgian, and French experts have generally concluded that a steel mill would not be a paying proposition on the scale envisaged by the Iranian Government. Many Iranians believe, however, that the Western countries have denied Iran a steel mill in order to retain a market for their finished goods, and so over the years the acquisition of one has become a matter of honor as a symbol of modernization and of relief from "colonialism." When the Shah visited the USSR in June 1965, he accepted Moscow's offer to provide a mill.

Under the formal agreement, signed on 13 January, the USSR will provide credits to be repaid over a 12-year period at 2.5-percent interest. The credits will provide financing for capital goods imported from the USSR and possibly from Eastern European countries and for Soviet assistance in planning, supervising construction of the facilities, and training Iranians to operate the plants. Other costs, both foreign exchange and "local," are to be borne by the Iranian Government.

The steel mill, to be located near Isfahan in central Iran, will have an annual capacity of about 600,000 tons of crude steel. Ancillary facilities are also to be developed, such as iron ore mines at Kerman 400 miles southeast of Isfahan, coal mines at Kashan 100 miles to the north, connecting

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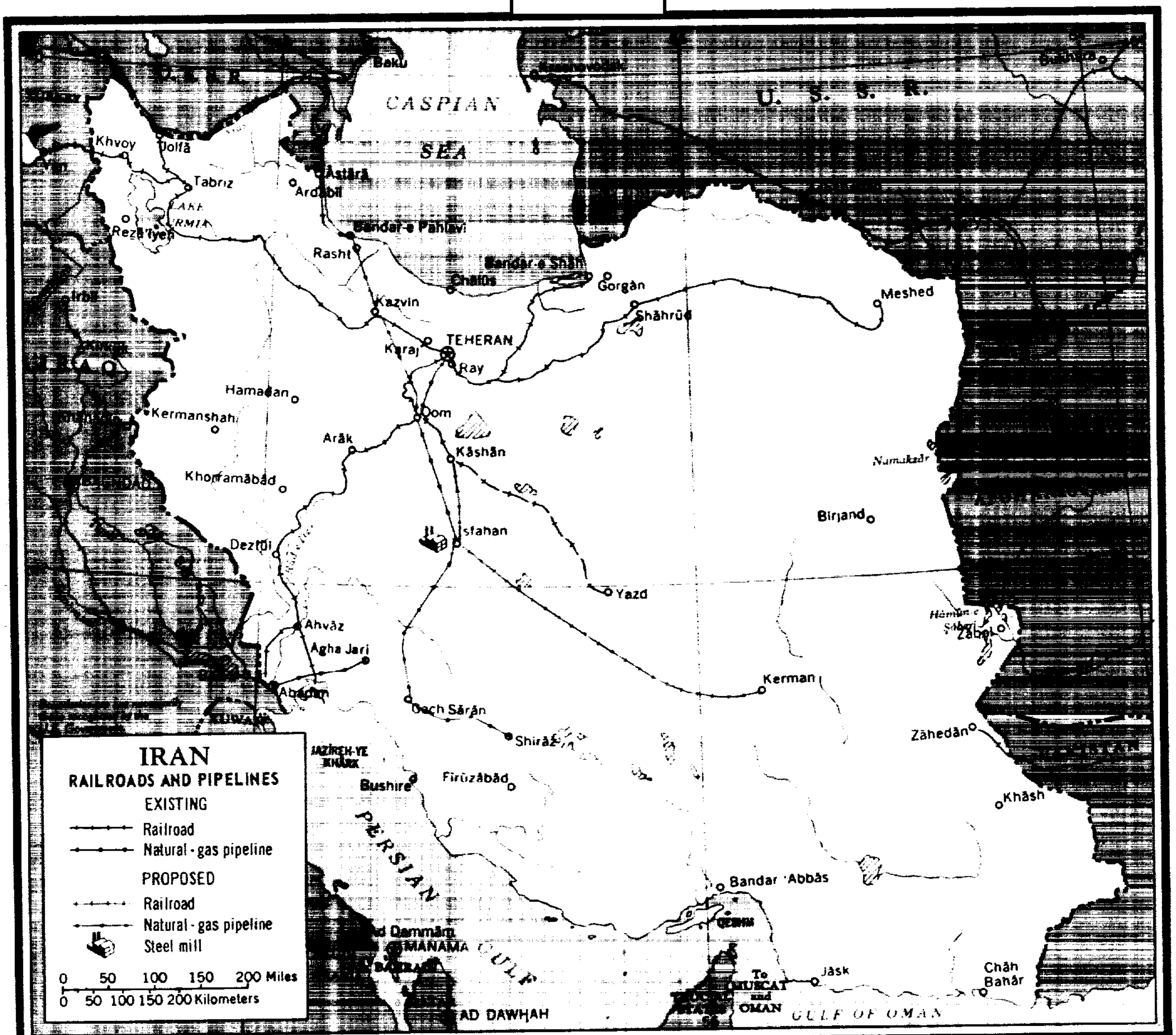

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railroads, and dams and canals for water supply.

The credit is to be paid off mainly through the sale of presently unmarketable Iranian gas. To transport the gas from the Agha Jari - Gach Saran oil and gas fields in the south, a pipeline will extend some 800 miles via Isfahan, Qom, Teheran, Kazvin, Rasht, and Bandar-e Pahlavi to Astara on the Soviet border. The pipeline is planned to be 42 and 48 inches in diameter and to have a capacity of approximately 15 billion cubic meters of gas annually through the major potential consuming centers in Iran and about 10 billion cubic meters through the remaining section to the Soviet border. A series of compressor and pumping stations will be included.

The machine tool plant is planned to have a capacity of about 30,000 tons a year.

Financing Problems

The estimated cost of this whole program is on the order of $900 million to $1 billion--$300 million for the steel mill, $125 million for supporting projects (railroads, dams, and mine development), $475 million for pipeline (including compressors and gas turbines), plus the cost of the machine tool plant and a pipe-making facility. Thus, in addition to the credit obtained from the USSR, Iran will need to obtain about $600 to $700 million from other sources, about two thirds of it in foreign exchange. Iran now is negotiating with West Germany for the purchase of a plant, at an estimated cost of $53 million, to produce pipe for the pipeline.

Iran is also considering a series of related projects that would grow directly out of the proposed program. These projects include a steel rolling mill, automation of the country's whole oil and gas pipeline network using a complex electronic control system, a petrochemical complex based on natural gas, irrigation systems based on the water supply facilities associated with the steel mill, and a host of small industrial plants utilizing gas from the new pipeline. As yet, none of the related projects has been incorporated into a specific development program; their eventual development is largely conjectural.

Foreign Exchange Needs

The cost of the new package --the steel complex, pipeline, and machine tool plant--will place a serious burden on the Iranian economy. The drain on foreign exchange will be especially heavy. Some $400 to $500 million in foreign exchange financing in addition to the Soviet credit must be found before 1970.

At present, the Shah envisages that most of the required funds will become available from expanding revenues from rapidly increasing oil output by the Western oil companies operating in Iran. In an effort to obtain these revenues, he is placing

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intense pressure on the companies to increase output this year by 20 percent over that in 1965 and to continue the rapid rise in output over the next five years.

This aim seems unrealistic. Iran's production has been increasing at less than half this rate. In 1965, production was only 8 percent over that in 1964. In view of an already saturated world market for oil, the companies consider a 10-percent increase in Iranian production this year to be the maximum possible.

Consequently, to obtain the needed foreign exchange Iran will have to curtail some of its proposed military expenditures, reduce other economic investment already called for in its current five-year plan, resort to additional long-term foreign borrowing, or take some combination of these actions.

Possible Benefits

If, however, Iran can find the necessary funds for the new package and the projects eventually are completed, it will gain substantial economic benefits. Throughout the construction phase of the program, substantial domestic employment will be generated and numerous firms will participate in the construction, thus stepping up the general level of economic activity. When completed, the steel mill complex will provide employment for more than 8,000 workers. As most of Iran's requirements for crude steel will be met, about $200 million in foreign exchange will be saved annually. Although the cost of steel to consumers in local currency may be somewhat higher than that of imported steel, the foreign exchange saved could be utilized for further investment in development.

The pipeline, when completed, will enable Iran not only to sell enough natural gas to the Soviet Union to meet repayments on the credit but also to acquire the equivalent of more than $500 million in purchasing power in the USSR over the 12-year amortization period. Moreover, the availability of gas fuel almost certainly will result in the development of small industry, both public and private, along the route of the pipeline. Coal production and rail facilities developed for the steel mill will be available for other purposes and the water systems developed for the mill could also help to expand irrigation.

Aside from the economic benefits to Iran, both the USSR and the Shah have already received significant political benefits. As Soviet specialists proceed on preliminary work on the steel complex, the USSR will improve its image as a good neighbor and probably will find greater public acceptability in the future. The Shah, while wary of excessive Soviet influence, has garnered considerable public approval for his closer relations with the USSR by demonstrating that he is not under the thumb of the US. (SECRET NO FOREIGN DISSEM)

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